Nonprofit Conversions and Student Success
Recommendations for Accreditors

In recent years, numerous for-profit institutions of higher education have entered into transactions centered around the institution modifying its corporate structure in order to obtain nonprofit designations from both the Internal Revenue Service (“IRS”) and the U.S. Department of Education (“Department”). But the corporate behaviors that have plagued students attending many for-profit colleges do not end simply because an institution has changed its tax status and analogous status with the Department. And given that nonprofit institutions are subject to less restrictive statutory and regulatory oversight, accreditor review at a transitional moment such as a conversion is critical. Unfortunately, the entire higher education triad, including accreditors, have not devoted sufficient attention to scrutinizing and responding to these corporate transactions.

In theory, conversions could have benefits. Critics of proprietary schools often claim that the profit-maximizing motives of for-profit colleges incentivize risky practices that have harmed many students in the past. When an institution becomes a nonprofit, many of these structural incentives may disappear. Therefore, nonprofit conversions are, in theory, a positive development for higher education, because no part of the net earnings of the post-conversion institution can inure to the benefit of any shareholder or individual.

Unfortunately, the theoretical is not always reflective of reality. In practice, there is a growing trend of for-profit institutions using conversion to avoid federal law, to improve public image, or some combination thereof. These incentives are real. For example, under the Higher Education Act (“HEA”), any for-profit institution that opts to participate in the federal student aid programs must derive no more than ten percent of revenue from sources other than funds provided under Title IV of the HEA. This rule—often referred to as “the 90/10 Rule”—does not apply to nonprofit and public institutions, which therefore have greater freedoms with respect to proportionate sources of revenue. Moreover, all programs offered by for-profit institutions must satisfy the statutory and regulatory requirement that they “prepare students for gainful employment in a recognized occupation.”

The Department’s 2014 Gainful Employment regulations implemented that requirement by requiring institutions to maintain proportionate debt levels for program graduates, as compared to the post-graduation earnings levels of those same graduates. These same regulations require for-profit institutions to make specific disclosures regarding the employment and debt outcomes of graduates.

Broadly speaking, in adopting the 90/10 Rule and Gainful Employment provisions, Congress intended to ensure that proprietary institutions of higher education were subject to a higher degree of scrutiny than their nonprofit and public counterparts. Indeed, Congress created this distinction between for-profit and nonprofit institutions and applied additional requirements to for-profit institutions, because it implicitly recognized that the profit-maximizing goals of for-profit education could put students and taxpayers at risk.

This paper affirms the authority of accrediting agencies to oversee nonprofit conversions and provides specific recommendations for heightened monitoring of an institution after a conversion. Our aim is to assist accrediting agencies in rooting out bad actors, while providing tools to approve bona fide conversions that benefit students and improve higher education.

CONVERSIONS ARE NOT ALWAYS AS THEY SEEM

“You cannot profit from a nonprofit” Carl B. Barney, CEO of for-profit CollegeAmerica. Barney sold several for-profit colleges to nonprofit, Center for Excellence in Higher Education and remained as sole chairman, collected $5.1 million in rent, and financed $431 million to the nonprofit to complete the sale.

When a for-profit college undertakes corporate restructuring to effectively become a nonprofit institution, the results may not always be as promised. Through simple or complex mechanisms such as engaging third party management contracts with interested parties, numerous post-conversion
institutions have continued remitting revenue to the owners of the former for-profit. Accordingly, accreditors must be vigilant when scrutinizing these transactions.

In recent years, we have seen some of the most controversial for-profit institutions—many encumbered by state and federal law enforcement investigations—attempt or effectuate a change in tax status. Institutions such as Stevens-Henager College, CollegeAmerica, Grand Canyon University, Ashford University, Kaplan University, Argosy University and the Art Institutes chain have all undergone transactions of the sort we consider “conversions.” And while it may be too soon to claim that none of these transactions have benefited students, it is clear that many have not.

Take, for example, the case of Argosy and the Art Institutes, formerly owned by the publicly-traded Education Management Corporation (“EDMC”). In 2017, Dream Center Education Holdings (“DCEH”), with the backing and involvement of the nonprofit Dream Center Foundation, purchased a group of schools from EDMC—converting them into nonprofit entities.9

Prior to the purchase, critics questioned whether DCEH was qualified to manage a large educational company. What followed was a parade of horribles for students. Many of the schools lost their accreditation during the change in ownership process and concealed that fact from current and prospective students. Eventually, the post-conversion institutions suffered a financial demise, closing about 30 campuses and disrupting the lives of thousands of students by the end of 2018.10 In January 2019, DCEH entered a federal receivership in an attempt to restructure and seek a buyer, while avoiding a bankruptcy that would have cut off all Title IV funding.11 It quickly became clear that the company faced a severe cash shortage, as creditors, landlords, and vendors clamored for a voice in the receivership proceedings. To make matters worse, roughly $16 million in federal student aid living stipends went missing, devastating students who depended on those funds to pay their rent and basic expenses.12

At the outset, accrediting agencies must adjust oversight and evaluation to understand and identify evolving corporate structures. As highlighted by recent conversions, entities have used a variety of tactics to maintain a profit-stream from the post-conversion institution, while also maintaining influence and control over the operations of the new nonprofit. Below are several tactics by for-profit entities we have identified.

**Conflicts of Interest with New Leadership:** A significant conflict of interest exists when a newly formed nonprofit transitions the for-profit corporate board (or family members of an interested party) onto its board of directors. This arrangement could allow the for-profit undue influence over the nonprofit’s governance. Boards of directors oversee the operations of the nonprofit; therefore, the nonprofit school is vulnerable to unfair service contracts, financial risks, and poor oversight in lieu of revenue. This is at odds with the fundamental mission of a nonprofit and risks financial instability. Accreditors must evaluate the proposed board of directors for the nonprofit entity to determine if a significant conflict of interest exists. If one is identified, determine the best course of action to eradicate the conflict of interest or minimize the undue influence.

**Excessive Servicing Contracts with For-Profits:** Institutions converting to nonprofit status may seek to maintain a profit-stream by affixing generous service contracts

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between the for-profit corporation and the (new) non-profit institution. The nonprofit school may outsource the operations of admissions, student recruitment, human resources, financial aid, or facilities maintenance to the for-profit, or a closely affiliated for-profit company. Therefore, a school may have a nonprofit designation, but the operators could maintain its profit-driven tactics proven harmful to students, without the concomitant regulatory scrutiny of a for-profit institution. Before approving the conversion, accreditors must address service contracts with the for-profit parent company and evaluate their potential windfall or undue influence onto the nonprofit. If the accreditor identifies overly generous servicing or online program management contracts, or contracts that raise other red flags, accreditors should determine the best course of action, which may include adding conditions before approving the conversion.

**Real Estate Sales and Financing with For-Profit Entity:** Certain for-profit schools have unfairly profited from a nonprofit conversion because executives sold the physical campus infrastructure to the nonprofit at a premium. Additionally, some for-profit entities have structured a financing agreement to the nonprofit with additional interests and prepayment penalties. Accreditors must scrutinize the potential windfall for a for-profit parent company with regard to real estate deals and determine if the agreements are reasonably in line with market value and industry standards.

**THE AUTHORITY OF ACCREDITING AGENCIES**

Accreditation in the United States began "as a means of ensuring academic quality through a nongovernmental peer review process." But "over time the [accreditation] process [has] evolved," and accreditation is also now a prerequisite for a school to participate in federal student aid programs. Although the primary function of accreditation has been to monitor academic quality, recent trends in higher education, including those discussed above, suggest that in order to protect students, a greater emphasis must be placed on the corporate and financial structure of proprietary institutions. The tie to academic quality is clear: numerous for-profit institutions have abruptly closed in recent years, leading to major educational disruption. Some schools have closed not long after the attempted or actual conversion—this was the case of schools operated by Dream Center, as well as with certain former schools owned by Corinthian Colleges that were later transferred to the nonprofit Zenith Education Group. With each closure, academic credits are lost, transfer and teach-out options are limited, and students’ academic success is interrupted, or simply cut-off. Any oversight that focuses on assuring academic quality must therefore take into account the long-term stability and viability of institutions undertaking corporate restructuring.

Consistent with this approach, Congress has given accreditors the flexibility and authority to fill regulatory gaps. Accreditors must have standards to address the "fiscal and administrative capacity" of an institution, “as appropriate to the [relative] scale of operations.” Accreditors must also have standards that “respect the stated mission of the institution[s] of higher education it accredits.” And of course, Congress has expressly granted authority to accrediting agencies to “adopt[] additional standards not provided for in [the HEA].”

**SPECIFIC RECOMMENDATIONS**

In light of the problems outlined above and accreditors’ extant authority to impose and apply standards on institutions of higher education, Student Defense recommends that accreditors condition any approvals of conversions on the creation of certain robust student protections. Although we make this recommendation with respect to all conversions, these recommendations are particularly important for institutions with histories of misconduct or poor outcomes. Obviously, imposing the conditions recommended here is not a substitute for rigorous review of the conversion to determine, in the first instance, if the post-conversion is acting as a bona fide nonprofit institution. Moreover, accreditors should periodically review conditions, rather than impose permanent requirements for post-conversion institutions. For example, an accreditor may condition approval of non-profit conversion with a temporary restriction period. If the post-conversion institution has operated properly during the restriction period, an accreditor could consider lifting certain restrictions.
We offer the following recommendations:

1. **Establish A Recovery Fund to Protect Students from Fraudulent, Deceptive, or Misleading Conduct, Abrupt Closures, or Cessation of Programs**

   Given the financial risks associated with undertaking a corporate restructuring, accreditors should take strong action to protect students financially.

   In this regard, accrediting agencies should require a post-conversion institution to escrow or otherwise set aside funds in an appropriate financial vehicle in order to cover any liabilities to past, current, or future students resulting from institutional misconduct and the potential of abrupt campus closures or other instructional or programmatic cessation. We do not, in this paper, opine on the best financial vehicle, but we note that the funds should be set aside in a way that is beneficial to students even if the post-conversion institution lands in bankruptcy. The funds should be monitored by the accreditor or an appropriate entity as determined by the accreditor. The amount of funds should be set on a case-by-case basis, considering not only the size of the institution, but also the extent to which student financial interests are protected by various states, as well as the potential liabilities associated with a particular school. For example, students attending schools with lower 90/10 ratios may be less protected by the federal closed school discharge regulations (at least in terms of the extent of that financial protection). At the same time, students who are protected by state laws and regulations that include robust tuition recovery funds may be better protected in the event of closure. Accreditors should consider all of these factors when setting the size and term of financial protections.

   Accreditors can continue to monitor the post-conversion institution in order to ensure that the amount required to be set aside is appropriate given the size of the institution and the nature of any alleged or actual misconduct. On a case-by-case analysis, accreditors can also determine the appropriate length of time, considering, at a minimum, all applicable statutes of limitation, for the post-conversion institution to maintain the set-aside funds as such.

2. **Adopt Strict Student Debt and Revenue Benchmarks**

   Accreditors should create and enforce student debt benchmarks that post-conversion institutions must meet over a period of years or face the loss of accreditation. Under the 2014 Gainful Employment regulations, the Department requires student debt benchmarks for for-profit schools, which include debt-to-earnings ratios or program and campus-level cohort default rate. Those same regulations require that program cohort default rates be adjusted for institutions that undergo certain changes in status. Accreditors should set higher expectations for post-conversion institutions with a history of misconduct than that required by federal regulation. Agencies should require these heightened standards for a period of time post-conversion, and also require all post-conversion institutions to comply with the 2014 Gainful Employment regulations and the 90/10 Rule for a certain time period.

   Fact-specific analyses should guide the duration and extent of these requirements. For instance, for institutions with a history of targeting veterans, accreditors should consider counting GI Bill and Department of Defense funding toward the 90% figure. Other schools, particularly those with a history of abuse, should be limited to 80/20 or 85/15 funding levels. For institutions with particularly poor debt-to-earnings levels, accrediting agencies can require compliance with standards above those required by the 2014 Gainful Employment rule. Agencies can monitor compliance with these standards to determine when the requirement can be lifted, if at all, as a condition of accreditation.

   To the extent that student debt benchmarks are not otherwise calculated by the federal government or the institution, the accreditor should require an earnings survey of select programs with historically low rates in a way that follows the Department of Education’s 2015 guidance.

3. **As Circumstances Require, Appoint an Independent Official to Oversee the Converting Institution’s Marketing and Recruiting Practices**

   Where a pre-conversion institution has a history of law enforcement activity, accreditor scrutiny, or private litigation...
regarding marketing or recruitment tactics, an accrediting agency should appoint, as a condition of approval, an unaffiliated party with experience in consumer protection and higher education to monitor all marketing and recruiting efforts at the post-conversion institution.

Monitors have been successfully used with respect to a number of institutions of higher education and can be of tremendous value when required to issue periodic reports regarding the institution under monitorship. For example, the court-appointed Settlement Administrator appointed to monitor the compliance of schools owned by EDMC, later Dream Center, has been an important piece of ensuring that student interests were protected following the sale of those institutions to the Dream Center entities. Monitors must be independent and, for example, should not involve attorney-client relationship between the monitor and the institution. This was, unfortunately, the case with respect to the first monitor that the U.S. Department of Education imposed over the Zenith Education Group, following that entity’s purchase of certain schools owned by Corinthian Colleges. The accreditor should assert authority over, and indeed remove, any monitor that is less than independent.

The length and extent of the monitorship can be determined by agreement, and in a fact-specific way. By way of example only, monitors can:
- Monitor the transition to the new management structure and compliance with any conditions placed on that structure by the Department, the accreditor, or a state authorizing agency;
- Review staffing levels and compliance infrastructure and culture;
- Monitor financial stability;
- Oversee employee trainings;
- Develop "secret-shopper" programs for internal review;
- Review third-party and vendor contracts and compliance, including arrangements with online program management partners and lead generators;
- Review closure plans;
- Assess accuracy of statements made by recruiting agents during telephonic and face-to-face meetings with prospective students;
- Review enrollment agreements, course catalogs, and school webpages for compliance with federal and state law, including UDAAP and Truth in Lending requirements; and
- Recommend changes to public and student-facing materials, and ensure that changes are timely made.

Agencies should also require that monitor reporting be provided not only to the accrediting agency, but also to other members of the triad and the public at large.

5. LIMIT THE USE OF LEAD GENERATORS TO COLLECT CONSUMER INFORMATION

Lead generation is the process of identifying and cultivating individual consumers who are potentially interested in purchasing a product or service. In higher education, lead generators collect consumer contact and other information and sell it to schools as "leads." Schools then use the leads for their own purposes, including to market their products and services. As frequently reported, lead generators often engage consumers through fraudulent or misleading representations about employment opportunities or the "best affordable colleges." In fact, they are gathering personal information in order to sell it to schools seeking new students at amounts ranging, in one recent case, from $22 to $125 for each lead.

For-profit colleges have a history of working with lead generators that have been accused of deceptive marketing. For example, on January 18, 2018, the Federal Trade Commission ("FTC") announced that it issued a final order settling charges that lead generator Victory Media violated Section 5 of the FTC Act in connection with its promotion of post-secondary schools—including for-profit institutions such as Kaplan—to military consumers. According to the FTC’s complaint, some of Victory’s materials and tools deceptively promoted schools that paid the company for those promotions, including schools that the company had not deemed “military friendly.”

Unless an agency is going to ban the use of lead generators altogether, accreditors should require post-conversion institutions to only work with lead generators that clearly and conspicuously disclose when personal information would be sold to a third party. Additionally, agencies should ensure that post-conversion institutions must also receive
consumers’ express, informed consent for the sale, transfer, or disclosure of such information. Accreditors should also review the contracts of all third-party lead generators, third-party servicers, bundled servicers, and other outside/online marketing vendors used by the converting institution and confirm with the FTC, Consumer Financial Protection Bureau, Better Business Bureau, Online Lenders Alliance, and relevant state prosecutors that these entities have not received complaints or been under recent investigation. In addition, consistent with Online Lenders Alliance Best Practices, accreditors should require converting institutions to obtain representations and warranties from all lead generators that they will comply with all applicable laws, regulations, and best practice guidelines for lead generators. Finally, accreditors should also prohibit converting institutions from advertising on third-party websites, including military and education-related websites, unless those websites expressly state that the sites are not government or military-affiliated and that, where accurate, the institution pays to appear on the site.

6. ENHANCE CONSUMER-FOCUSED TRAINING FOR ALL EMPLOYEES OR AGENTS OF THE POST-CONVERSION INSTITUTION WHO DIRECT OR ENGAGE IN STUDENT RECRUITMENT OR ENROLLMENT

Although this requirement can—and should—be extended beyond converting institutions, agencies should require that post-conversion institutions establish and implement strong consumer protection trainings for all officers, employees, and agents who direct or are involved in any aspect of the student recruitment process. Accrediting agencies can require that a designated individual—potentially an independent monitor—be appointed to coordinate and oversee the implementation of the program. Such a program could educate participants about fair advertising principles, recruitment tactics, and similar consumer-oriented best practices.

7. MONITOR AND OVERSEE CONTRACTS WITH ONLINE PROGRAM MANAGERS

In recent years, higher education has seen a rapid growth of online program managers (“OPM”), companies that design and run online content for all types of institutions. These companies frequently are paid a percentage of tuition revenue generated by their programs. As others have noted, the use of OPMs has created generous profit margins for both OPMs and the colleges that retain them. For this reason, accreditors must scrutinize the use of OPMs, and the contractual arrangement between any OPM and the converting institution to ensure that student interests are protected. This means that there should be an arms-length relationship between the school and the OPM, and that the pricing structure is consistent with the nonprofit status of the post-conversion institution. Accreditors should also require heightened ratios of the percentage of academic activity that is allowed to be outsourced to an OPM for institutions with histories of poor outcomes.

8. INCREASED SCRUTINY AT THE CROSSROADS OF RECRUITMENT TACTICS AND LABOR-MARKET CONSIDERATIONS

The growth in data sources in the online economy has spurred the growth of companies like Burning-Glass Technologies and Emsi that use data analytics to align higher education program offerings with almost real-time, localized assessments of labor market demand. These sorts of platforms can obviously have great benefits for institutions and students alike, insofar as they can be used to drive educational programs that are preparing students for the jobs that are available in the local economy.

But these tools are ripe for accreditor use as well. Accreditors can use labor-market analytics to not only determine whether a converting school is designed to truly meet the employment demands, but also to assess whether a school is marketing itself in a way that is consistent with those demands. Schools that are promoting programs in a way that is misaligned with economic needs may, in fact, be doing so in violation of state consumer protection laws.

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Accreditors command more power to impose conditions onto the nonprofit governance at this pre-conversion stage. Accreditors should take this opportunity to stamp out profit-driven tactics to prevent future problems at the post-conversion institutions. Also, post-conversion, accreditors should implement procedures into their ongoing monitoring
and audits to evaluate whether a newly formed nonprofit is
governed or operated to benefit private interest.

CONCLUSION
Accrediting agencies have a critical enforcement role for
post-conversion institutions. Student Defense contends that
the challenges and dangers posed by the for-profit industry
do not end simply by virtue of an institution changing its
tax-status and receiving approval by the U.S. Department
of Education. Given that nonprofit and public institutions
are subject to less scrutiny by regulators, adequate accred-
itator review is more important than ever. Accreditors can
strengthen their oversight of the growing number of non-
profit conversion requests by for-profit institutions through
innovative uses of the recommendations discussed above.
By utilizing tools that include financial audits, site-visits and
analysis of outcomes data, regional and national accreditors
can enhance their work to protect students and improve
outcomes at schools during and after the conversion process.
ENDNOTES

1 Although the nature of these transactions have varied, for purposes of this paper, we consider these corporate restructurings as nonprofit “conversions.”

2 As a basic principle, the Higher Education Act and its implementing regulations require that a nonprofit institution of higher education be “owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual,” be “legally authorized to operate as a nonprofit organization by each State in which it is physically located,” and have been “determined by the IRS to be an organization to which contributions are tax-deductible in accordance with section 501(c)(3) of the Internal Revenue Code.” 34 C.F.R. § 600.2 (defining “nonprofit institution”). See also 20 U.S.C. § 1002. The third prerequisite – IRS determination – commands that the IRS determine, inter alia, that “no part of the net earnings” of the entity “inures to the benefit of any private shareholder or individual.” 26 U.S.C. § 501(c)(3). Notably, this third requirement is in addition to the requirement that the Department determine that the institution is owned and operated by a nonprofit corporation or association, and that no part of the net earnings of which benefit any private shareholder or individual.


4 Post-conversion institutions must not have net earnings that benefit any private shareholder or individual. 26 U.S.C. § 501(c)(3). This is often referred to as the “private inurement” rule.

5 20 U.S.C. §§ 1094(b)(25), (d); see also 34 C.F.R. § 668.28.


7 Id.


14 Id.


18 20 U.S.C. § 1099(g).

19 34 C.F.R. § 668.502; 34 C.F.R. § 668.404.

20 34 C.F.R. § 668.503.


23 See Fed. Trade Comm’n v. Expand, Inc., No. 16-cv-00714 (M.D. Fla. Apr. 28, 2016) (alleging that Expand, Inc. and its CEO misrepresented to consumers that they were applying for job openings when, in fact, defendants were selling consumers’ personal information – for up to $125 per lead – to schools and career training programs), available at https://www.ftc.gov/system/files/documents/cases/160915expandorder.pdf.


